BLANK PAGE

No. 472

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

vs.

RICHARD VAN NEST GAMBRILL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT.

SIDNEY W. DAVIDSON,
ALLIN H. PIERCE,
Counsel for the Respondent,
No. 2 Wall Street,
New York, New York.

BLANK PAGE

INDEX.

CITATIONS.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 472

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

vs.

RICHARD VAN NEST GAMBRILL.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT.

Opinions Below and Jurisdiction.

The opinion of the Board of Tax Appeals (R. 9-17) is reported in 38 B. T. A. 981. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 29-35), affirming the Board's decision in the instant case and also the Board's decisions in the related *Campbell, Knox* and *Rogers* cases (Nos. 473, 474 and 475, present Term), is reported in 112 F. (2d) 530.

The judgment of the Circuit Court of Appeals was entered June 28, 1940 (R. 35). The petition for certiorari was filed September 28, 1940, and was granted November 12, 1940 (R. 36). The jurisdiction of this Court rests on section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

In 1930 the taxpayer, Mr. Gambrill, sold certain securities which had been delivered to him in 1928 as remainderman of a testamentary trust upon the death of the life beneficiary. Some of these securities had been part of the corpus of the trust since the time of its creation in 1898, and others had become part of the trust corpus through action of the trustees in reinvesting the trust estate pursuant to powers given them in the will.

The questions here presented relate to the computation of Mr. Gambrill's income tax liability in connection with these sales, namely:

1. Under the Revenue Act of 1928, what is the "basis" for determining Mr. Gambrill's gains or losses from the sales of the securities?

2. Should those securities which Mr. Gambrill sold within two years from the date when the trust terminated and the securities were delivered to him by the testamentary trustees be treated as "capital assets" within the meaning of the capital gain and loss provisions of the Revenue Act of 1928?

Statutes Involved.

The statutes involved are set forth in the Appendix, *infra*, pages 31 to 34.

Statement.

This case involves the income tax of the respondent, Richard Van Nest Gambrill, for the year 1930. The amount of the tax deficiency asserted by the Commissioner of Internal Revenue is $11,753.40 (R. 5).

The Board of Tax Appeals decided all issues in favor of Mr. Gambrill. The Circuit Court of Appeals for the

Second Circuit reviewed the case in connection with the related *Campbell, Knox* and *Rogers* cases (Nos. 473-475, present Term) in which the Board of Tax Appeals likewise had rendered decisions favorable to the taxpayers, and in a single opinion it unanimously affirmed the Board's decisions in all four cases (R. 35). This Court granted certiorari in all of the cases, pursuant to a petition of the Commissioner which alleged that they were in conflict with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Maguire* v. *Commissioner*, No. 346, present Term.

The facts of the instant case were stipulated (R. 24-28). The following is a summary of the Findings of Fact made by the Board of Tax Appeals (R. 10-13):

On November 20, 1897, Mr. Gambrill's grandmother, Mary Van Nest, died testate a resident of the State of New York (R. 10). Her will, so far as here material, directed that a portion of her residuary estate be held in trust for the benefit of Mr. Gambrill's mother, Anna Van Nest Gambrill, during her life with full power in the trustees to invest and reinvest in their discretion without any limitations whatsoever; and that at her death the same be transferred and delivered "as she if leaving issue shall by will direct or in the absence of such direction, to her issue equally, or if she shall leave no issue," then to others as directed in the will (R. 10).

On January 4, 1898, the trust was set up in accordance with the terms of the will and the executors delivered to themselves as trustees certain common and preferred stocks (R. 10-11). The trust continued in existence for a period of more than thirty years until the death of the life beneficiary on March 23, 1928 (R. 11-12). During that period the trustees, acting under those provisions of the will which gave them unlimited power to invest and reinvest in their discretion, made a number of changes in the securities included in the corpus (R. 12-13).

In the original appraisal of the estate of Mary Van Nest, which was filed for the purpose of determining inheritance

tax under the then existing law of the State of New York, the appraiser reported that the value of the remainder interest of this trust was not at that time ascertainable. Accordingly, the assessment of the inheritance tax was suspended until such time as the person or persons beneficially entitled to the remainder should come into possession and enjoyment thereof, and the tax was made a lien upon the property transferred to the trustees. That lien continued in force throughout the period of the trust (R. 11).

On March 23, 1928, the life beneficiary, Anna Van Nest Gambrill, died without having exercised her power of appointment and leaving Mr. Gambrill, the respondent herein, as her sole surviving issue (R. 11). Thereupon the trustees procured an order from the Surrogate's Court of New York County assessing the inheritance tax on the value of the remainder interest passing to Mr. Gambrill (R. 11-12); and they sold certain of the trust property to provide funds for payment of that tax and other charges (R. 12). On May 5, 1928, the trustees delivered the balance of the corpus of the trust to Mr. Gambrill, as remainderman, "in accordance with the terms of the will of Mary Van Nest" (R. 12).

In February, 1930, on May 6, 1930, and in June, 1930, Mr. Gambrill sold certain of the securities which the trustees had delivered to him (R. 12). Some of these were securities which the trustees had received from the executors upon the creation of the trust in 1898, and others were securities which the trustees had purchased as reinvestments of the trust estate (R. 12-13).

Mr. Gambrill, in computing his gain or loss on each security for income tax purposes, used as his basis the fair market value of the security on May 5, 1928, the date on which he had received it from the trustees (R. 12). In computing his capital gains and losses, he regarded as a "capital asset" each security which at the time of its sale had been in his possession for more than two years from

May 5, 1928 (R. 13). This computation disclosed that, as a result of all the sales, he had incurred an ordinary loss of $5,550.57 and a capital net loss of $25,092.94 (R. 8).

The Commissioner of Internal Revenue, in his notice of tax deficiency, redetermined the amounts of the gains and losses by using the bases which would have been applicable if the securities had been sold by the trustees (R. 6-7); for those securities which had been acquired by the trustees prior to March 1, 1913, either by distribution from the executors or by purchase, he used the March 1, 1913 value, and for those securities which had been purchased by the trustees after March 1, 1913, he used the cost to the trustees (R. 7, 8). Also, he treated all the securities as "capital assets," on the theory that Mr. Gambrill had held them from the date of the testatrix's death or from the dates of their purchase by the trustees (R. 13, 27-28). By such computation he concluded that Mr. Gambrill had derived a capital net gain from all the securities of $60,053.32 (R. 8), and that there was a deficiency in tax of $11,753.40 (R. 5).

ARGUMENT.

POINT I.

The basis of all the securities is fixed by the third sentence of section 113 (a) (5) of the Revenue Act of 1928. It is the value of the securities at the time when the trustees delivered them to Mr. Gambrill in accordance with the terms of the will.

The controversy in regard to the basis for determining gains and losses on the securities here involved is centered upon the application and construction of the third sentence of section 113 (a) (5) of the Revenue Act of 1928 (*infra*, pp. 32-33). This sentence provides in substance that the basis of all "property * * * acquired either by will or by in-

testacy," except real estate and specifically bequeathed personalty, is "the fair market value of the property at the time of the distribution to the taxpayer."

In the opinions below, both the Board of Tax Appeals and the Circuit Court of Appeals for the Second Circuit held unanimously that the provisions of this sentence were applicable to all the securities, on the ground that Mr. Gambrill had acquired all of them by will; and that the phrase, "value of the property at the time of the distribution to the taxpayer," fixed the basis at the value of the securities when they were delivered to Mr. Gambrill on May 5, 1928.

The Government, in claiming error, makes two principal contentions:

1. It contends that the third sentence of section 113 (a) (5) applies only to part, not to all, of the securities which Mr. Gambrill received as remainderman. Its position is that the phrase, "property * * * acquired * * * by will," should be so construed as to make this sentence inapplicable to any of the securities which had become part of the trust estate through reinvestment by the trustees, and that the basis of such securities to Mr. Gambrill is their cost to the trustees (*Maguire* brief, pp. 27-28, 36-37).(1)

2. It contends that the phrase "time of the distribution to the taxpayer," when applied to those securities which had been part of the original trust estate, means the date when the executors transferred the trust estate to themselves as trustees in 1898, and that the basis of those securities to Mr. Gambrill is their value on that date. (*Maguire* brief, p. 16.) It makes no suggestion as to how this phrase should

---

(1) The Government in its brief in the instant case (p. 19) has incorporated by reference the argument in its brief in *Maguire* v. *Helvering*, No. 346, present Term.

be construed in respect of those securities which were reinvestments of the trust estate, if it is held that the third sentence of section 113 (a) (5) is applicable to all of the property which Mr. Gambrill received as remainderman.

The following argument is directed toward these two contentions, for all other contentions made by the Government in respect of the basis issue are incidental thereto.

(A) The purpose and application of subparagraph (5) of section 113 (a).

The Revenue Act of 1928 clearly and specifically declares how gain or loss from the sale of property shall be determined. Section 111 provides in substance that it shall be the difference between "the amount realized" and "the basis provided in section 113"; and section 113 (a) states that the basis shall be "the cost of such property," except that if the facts cause one of the twelve subparagraphs to be applicable the basis of the property shall be that prescribed in such applicable paragraph. The parties agree that paragraph (5) is the only one of these subparagraphs which has any possible application in the present case, and that the pertinent provisions of this paragraph are contained in the third sentence. It is evident therefore that the basis of each of the securities which Mr. Gambrill sold must be either "the cost of the property" as prescribed by the general provision of section 113 (a) or the "value of the property at the time of the distribution to the taxpayer" as prescribed by the third sentence of subparagraph (5), for no other basis is authorized by the statute.[2]

---

[2] The Government agrees (brief herein p. 3, footnote 1) that the provisions of section 113 (b), pertaining to property acquired before March 1, 1913, need not be considered for, if applicable, the material portion of those provisions incorporates section 113 (a) (5) by reference.

The purpose of subparagraph (5), as its terms and position in the statute disclose, is to provide an exception to the "cost of the property" rule in cases where the taxpayer acquired the property either by will or under laws of intestate succession. Property thus acquired ordinarily costs the taxpayer nothing and, as its value at the time of receipt is excluded from gross income under section 22 (b) (3), no constructive cost is established through subjecting the item to income tax as is sometimes done in the case of taxable stock dividends, bonuses and extra compensation for personal service. Thus property of this character has no "cost" and, if subparagraph (5) had not been enacted (or is found inapplicable), its basis under the general provision of section 113 (a) would be zero. Cf. *Helvering* v. *Gowran,* 302 U. S. 238 (1937). The inequitable result would be that tax-exempt inheritances could not be liquidated without making the whole of the proceeds taxable.

This conclusion finds support in the action taken by the Treasury Department in administering the various income tax statutes enacted prior to 1921, none of which contained any specific provision comparable to subparagraph (5). In the Revenue Act of 1918 (Sec. 202) the only basis provided for determining gain or loss on the sale of assets was cost or March 1, 1913 value. The Treasury Department, recognizing the inadequacy of this provision, promulgated a regulation which stated that the basis of property acquired by "inheritance" was the "appraised value at the time of the death of the testator" (Reg. 33 (1918 revision), par. 44). Since this basis was not authorized by statute, the regulation may have been invalid (Cf. *Koshland* v. *Helvering,* 298 U. S. 441, 447 (1936)); but whether valid or not, the regulation shows that from the time of the earliest income tax statutes, the "cost of the property" rule has been deemed inappropriate and inapplicable in fixing the basis of property acquired tax-free either by will or by inheritance. At all times since 1921, the Revenue Acts have provided specifically an ex-

ception to the "cost of the property" rule similar to that contained in subparagraph (5) of section 113 (a).

The Government apparently agrees that the purpose of subparagraph (5) is that stated above, and that under the general provisions of section 113(a) the "cost" of tax-exempt inheritances would be zero (*Maguire* brief, p. 15). Also it agrees that the third sentence of subparagraph (5) controls the basis of any property received by the remainderman of a testamentary trust which either had been owned by the testator or had been purchased by the executors as a reinvestment of the estate (brief herein, p. 20). It disagrees however that this provision also controls the basis of any property included in the remainder which was a reinvestment of the trustees. Its contention is that reinvestments of testamentary trustees when distributed to the remainderman may not be regarded as "property * * * acquired * * * by will."

It is respectfully submitted that such construction and application of section 113 (a) (5) is unwarranted. As will be hereinafter demonstrated, it finds no support in related provisions of the statute or in the legislative history of this particular provision, and it conflicts with the weight of judicial authority. Moreover, since subparagraph (5) was enacted to provide substantial bases for property which a beneficiary receives tax-exempt and without cost, its application should not be subjected to unexpressed limitations which would in a large measure defeat its purpose.

Some indication of the scope of subparagraph (5) is found in the application of section 22 (b) (3) which provides the exemption for "property acquired by * * * bequest, devise or inheritance." As has been noted above, section 113 (a) (5) is closely related to this exemption provision for it was intended to provide bases for tax-exempt inheritances; and since it is couched in even more general terms the presumption is that its application is at least co-extensive.

In *Lyeth* v. *Hoey*, 305 U. S. 188 (1938), the application of section 22 (b) (3) of the Revenue Act of 1932 (identical

in the 1928 Act) was considered by this Court. The Government there contended that the exemption provision should be construed narrowly, and that property received by an heir in compromise of a will contest should not be exempt but should be taxed in full as income.(3) The Court rejected these contentions with the following statement (p. 194):

> "In exempting from the income tax the value of property acquired by 'bequest, devise, or inheritance,' Congress used comprehensive terms embracing all acquisitions in the devolution of a decedent's estate. * * * Thus the acquisition by succession to a decedent's estate whether real or personal was embraced in the exemption."

Certain it is that the exemption provided by section 22 (b) (3) is not lost to beneficiaries and remaindermen if the executors or testamentary trustees, acting under powers granted them in the will, invest or reinvest the estate entrusted to them. In some cases the specific property which the testator had owned may be too speculative for fiduciaries to hold, and prudent administration may require that it be converted into other property of more conservative character. In other cases, securities of the estate or trust may

---

(3) The Government in its brief (*Lyeth* v. *Hoey*, No. 48, October Term 1938) said (p. 25):

> "But it [the word inheritance] is not applicable, in a loose sense, to all distributions of a decedent's estate, even under supervision of a probate court. * * * The exemption applies only to property received from a decedent, to which the taxpayer was entitled to succeed by virtue of the laws regulating intestate succession."

On page 40 of the brief the following comment was made regarding section 113 (a) (5):

> "This provision, which is obviously *in pari materia* with the exemption from income accorded by Sec. 22 (b) (3), applies only to property which was actually part of the decedent's estate * * *."

mature or be called for redemption, and the fiduciary may find it necessary to make new investments in order to protect the income of those beneficially interested. All such reinvestments become part of the devolving estate, and when distributed to the beneficiary or remainderman, they are exempt from tax under section 22 (b) (3) as property acquired by "bequest" or "inheritance."

For the same reasons, it is submitted, the basis provided by the third sentence of section 113 (a) (5) is not lost to the beneficiary or remainderman under similar circumstances. It cannot be presumed that Congress, in using the comprehensive terms, "property * * * acquired either by will or by intestacy," overlooked the necessity for prudent handling of testamentary trusts or intended that the special basis provisions prescribed in this sentence should become inapplicable if the specific assets originally received by the fiduciary were not held intact and distributed without any reinvestment being made.

Other indications that section 113 (a) (5) was intended to be comprehensive are found in its legislative history. When the Revenue Bill of 1928 was before the Senate Finance Committee, subparagraph (5) was revised to include the first three sentences of the paragraph as finally enacted; and the following explanation of the change was reported (Finance Committee Report No. 960, 70th Cong., 1st Sess., p. 26):

> "It appears that the House bill is inadequate to take care of a number of situations which frequently arise. For example, the executor, pursuant to the terms of the will, may purchase property and distribute it to the beneficiaries, in which case it is impossible to use the value at the decedent's death as the basis for determining subsequent gain or loss, for the decedent never owned the property. Moreover, the fair market value of the property at the decedent's death can not properly be used as the basis, in the case of property transferred in contemplation of death where the donee sells the property while the donor is living."

The Committee then stated in respect of the third sentence of section 113 (a) (5):

> "It would also apply in cases where the executor purchases property and distributes it to the beneficiary."

In view of the foregoing history, the Government concedes (brief herein, p. 20) that the provisions of section 113 (a) (5) apply to property received by a remainderman which had been purchased by the executors. That concession, however, is not adequate to give effect to the obvious intention of Congress to make subparagraph (5) sufficiently comprehensive to cover all property distributed under the terms of a will or the laws of intestate succession. The Senate Committee referred to property purchased by executors merely as one example "of a number of situations which frequently arise" where it was considered advisable to have the special basis provisions apply. There is no indication that reinvestments of testamentary trustees were intended to be excluded. Property purchased by any fiduciary under power given him in the will becomes part of the devolving estate.

In the present case the application of the third sentence of section 113 (a) (5) appears irrefutable, for Mr. Gambrill acquired all his rights and interests in all of the securities by the will of Mary Van Nest. That will prescribed the line of succession, it authorized the trustees to invest and reinvest the property entrusted to them, it determined when the trust should be terminated and it declared how the property remaining should be distributed. Moreover, at the time of this distribution the value of the remainder interest delivered to Mr. Gambrill was taxed under the local law of the State of New York as an inheritance. (R. 11-12).

The court below held that the third sentence of section 113 (a) (5) was applicable to all the securities here involved; and it rejected the Government's contention that this statute

did not apply to securities which had been purchased by the trustees, with the following statement (R. 33):

> "This requires a most technical interpretation of the clause [third sentence] and one that in our opinion is not sound even technically. Any property distributed by a trustee which is part of the corpus of the trust is acquired through and by virtue of the will. Through the will the remaindermen derived all their interests and without it they would have had no standing and would have received nothing. *Lyeth* v. *Hoey*, 305 U. S. 188, 194-195."

In *Reynolds* v. *Commissioner*, 114 F. (2d) 804 (C. C. A. 4th—1940), certiorari granted February 17, 1941, one of the issues was the basis under the 1934 Act of securities purchased and distributed by a testamentary trustee. The court said (p. 813):

> "The Commissioner points to no provision of the statute, other than §113 (a) (5), as applicable to such a situation, * * *."

The court also said (p. 813):

> "In our opinion, §113 (a) (5) of the Act covers securities purchased by the trustee in the administration of the estate and distributed to the taxpayer, as well as securities received by the trustee from the decedent's estate and similarly distributed. * * * We are in accord with the views expressed upon a similar question under the Revenue Act of 1928 in *Commissioner* v. *Gambrill*, 2 Cir., 112 F. 2d 530, 533. Cf. *Commissioner* v. *Maguire*, 7 Cir., 111 F. 2d 843."

In *Commissioner* v. *Libbey*, 100 F. (2d) 458 (C. C. A. 1st—1938), testamentary trustees acquired preferred stock by sale or exchange and distributed it to the beneficiaries. The Government apparently agreed that section 113 (a) (5) of the 1932 Act controlled and based its case solely upon the construction of that paragraph. The court held that this subparagraph was applicable.

In *Margaret E. B. Fleming*, 36 B. T. A. 773 (1937), the Government took a position precisely opposite to that which it is taking here. It opposed the taxpayer's contention that the basis of stock which had been purchased and distributed by the testamentary trustee was "cost" to the trustee; and it requested the Board to hold that the third sentence of section 113 (a) (5) of the Revenue Act of 1928 was applicable. The Board agreed and made the following statement in its opinion (p. 777):

> "* * * our immediately pertinent question is not *when* but *how* the petitioner, remainderman under the will of her father, not the trustee, acquired these securities. * * * But the testamentary trustee was not the agent of petitioner, the remainderman. The trustee was the creature of the decedent, made so by his will. It was thus designated as the continuing instrumentality of the decedent to execute his and not the will of the petitioner, remainderman.. She neither controlled the terms of the trust nor its res until distributed to her. * * * Thus, it was by virtue of the provisions of the testamentary trust created by the will of her father, that petitioner was the remainderman under that trust and received the securities in question. They may have been purchased by the trustee, but the petitioner acquired them by will."

This decision has been followed by the Board, in all similar cases, including the five cases here being considered (Nos. 346, 472, 473, 474, and 475, present Term).

The only decision to the contrary is that of the Seventh Circuit in the *Maguire* case (No. 346), which reversed the Board of Tax Appeals.

Assume, *arguendo*, that the Government is correct in its contention that those securities which had become part of the trust estate through reinvestment of the trustees were not, on distribution, acquired by Mr. Gambrill "by will." In such situation section 113 (a) (5) would not be applicable; but, we submit, the basis of the securities would nevertheless be the same as if it applied, i. e., their value on

the date of distribution. If the property was not acquired by will, it was not exempt from income tax at the time of receipt; and, being subject to tax at that time to the extent of its fair market value, that value would become its constructive "cost" basis for determining gain or loss on any subsequent sale. It is true that no income tax was paid upon the receipt of the property; but that fact is immaterial since estoppel is not pleaded and no grounds to support such a plea are present. Property which was subject to income tax at the time of receipt has, in the absence of estoppel, a basis equal to its fair market value at the time of such receipt. See *Robinson* v. *Commissioner*, 59 F. (2d) 1008 (C. C. A. 6th—1932); *Salvage* v. *Commissioner*, 76 F. (2d) 112 (C. C. A. 2d—1935), aff'd 297 U. S. 106 (1936).

There is no merit in the Government's suggestion (*Maguire* brief, pp. 36-37) that, if section 113 (a) (5) is not applicable, "it would be fair to assume" that the basis of those securities which were reinvestments of the trust estate is the cost to the trustees, rather than either the actual or constructive "cost" to Mr. Gambrill. Neither in the general provision of section 113 (a) nor elsewhere in the statute is there any authority for fixing a beneficiary's basis with regard to the manner in which testamentary trustees had obtained the property, or the price which such trustees may have paid for it, or the basis which such trustees would have been required to use if they had sold it. Nor is there any statutory authority for determining a beneficiary's basis by substituting the basis of testamentary trustees or any other prior owner; where Congress has intended that the basis of a prior owner should be substituted, it has made specific provision therefor (See subparagraphs (2), (3), (8) and (11) of section 113 (a)). The revenue acts regard a fiduciary as a distinct taxable entity whose income is computed, returned and taxed in the same manner as that of an individual; and where, as here, he is not the person who sold the property and derived the taxable gain, he is not the taxpayer and the determination of his basis is not a material consideration. *Hartley* v. *Commissioner*, 295 U. S.

216, 218 (1935); *Anderson* v. *Wilson*, 289 U. S. 20, 27 (1933). This court recognized in *Helvering* v. *Gowran, supra* (p. 244), that gain from the sale of property is the difference between the amount realized and the cost of the property "to the taxpayer." Also it held in *Koshland* v. *Helvering, supra* (p. 447), that where Congress has clearly and specifically declared how taxable gain shall be measured, the Secretary of the Treasury is without power by regulatory amendment to determine the gain by use of a basis which is not authorized by the statute.

Moreover, the reference which the Government makes (*Maguire* brief, p. 37) to article 113 (a) (5)-1 (d) of Treasury Regulations 86 (1934 Act)[4] weakens its position. That article, as its number indicates, pertains to subparagraph (5) rather than to the general provision of section 113 (a); and its purpose is to show how the doctrine of relation which is announced in the preceding paragraphs of that article should be used in applying the revised provisions of section 113 (a) (5) of the 1934 Act. The article by thus interpreting subparagraph (5) implies that the special provisions of this paragraph rather than the general provision of section 113 (a) are applicable in fixing the beneficiary's basis of property which had been purchased by testamentary trustees in their administration of the estate. It tends to support the respondent's contention that such property is acquired by will or inheritance.

---

[4] Section 113 (a) (5) of the Revenue Act of 1934, unlike the statute here involved, provides that the basis of property acquired "by bequest, devise or inheritance" is its value "at the time of such acquisition." Article 113 (a) (5)-1 of Treasury Regulations 86, in interpreting this provision, states that all titles to property acquired "by bequest, devise or inheritance" relate back to the death of the decedent; and subparagraph (d) of this article states that if the property is an investment by the fiduciary under a will, the cost or other basis of the fiduciary is taken in lieu of the value at the time when the decedent died.

It is respectfully submitted that all of the property which Mr. Gambrill received as remainderman was acquired by him "by will"; and that the third sentence of section 113 (a) (5) is applicable in determining its basis.

(B) Construction of the phrase "value of the property at the time of the distribution to the taxpayer."

The Circuit Court of Appeals for the Second Circuit, in its opinion below, made the following statements regarding the third sentence of section 113 (a) (5) and the principal contentions of the Government as to its construction (R. 32-33):

> "It is hard to imagine language which would more clearly fix the basis for computing the gain or loss realized upon the sales of the securities with which the Commissioner had to deal than the words 'fair market value of the property at the time of the distribution to the taxpayer.'
>
> * * * * *
>
> "The * * * contention of the Commissioner that the word 'taxpayer' as used in the third clause of Section 113 (a) (5) should be construed as meaning the 'trustee' and that the phrase 'time of the distribution to the taxpayer' ought to be interpreted as meaning 'the date when the executors transferred the property to the trustees,' seems to us without warrant. The taxpayers here are undoubtedly the respondents. The trustees are separate entities and as such are neither agents of the respondents nor mere passive fiduciaries. * * * To treat the trustee and beneficiary remainderman, as the Commissioner wishes us to do, as a 'sort of dual tax personality' is to disregard the plain language of the statute and to adopt a concept which seems to us to defy analysis. * * * the basis should be 'the fair market value at the time of the distribution to the taxpayer,' i.e., to the respondent whose income taxes are being reviewed, and not to the trustee."

The respondent submits that this holding is sound. It is directly supported by decisions of Circuit Court of

Appeals for the First Circuit in *Commissioner* v. *Libbey*, 100 F. (2d) 458 (1938), and *United States* v. *Van Nostrand*, 94 F. (2d) 510 (1938), aff'g 18 F. Supp. 295 (D. Mass. 1937); and by decisions of the Board of Tax Appeals in *Margaret E. B. Fleming*, 36 B. T. A. 773 (1937), *Lillian M. Brinton*, 28 B. T. A. 472 (1933), *Mary Colgate*, 27 B. T. A. 506 (1932) reversed by stipulation on another issue (C. C. A. 2d), *Ralph W. Harbison*, 26 B. T. A. 896 (1932) reversed on another issue 68 F. (2d) 1004 (C. C. A. 2d—1934), and also by the Board's decisions in the *Campbell, Knox, Rogers* and *Maguire* cases which are now before this court (Nos. 346, 473, 474 and 475).

The Government admits (*Maguire* brief, p. 25) that the point here involved was conceded by it in *Lane* v. *Corwin*, 63 F. (2d) 767 (C. C. A. 2d—1933), certiorari denied 290 U. S. 644 (1933); *Becker* v. *Anchor Realty & Investment Co.*, 71 F. (2d) 355 (C. C. A. 8th—1934); *United States* v. *Van Nostrand, supra*; and *Clyde* v. *Commissioner*, 32 B. T. A. 799 (1935). Also, it concedes (*Maguire* brief, p. 25) that the Bureau of Internal Revenue has not pursued a consistent construction of subparagraph (5), section 113 (a) of the Revenue Acts of 1928 and 1932; and that during the period 1933 to 1935 it construed this paragraph in a manner which accords with the decisions below.

The only judicial authority to the contrary is *Commissioner* v. *Maguire*, 111 F. (2d) 843 (C. C. A. 7th—1940), which is now before this Court (No. 346, present Term). The decision in *Jenkins* v. *Smith*, 21 F. Supp. 433 (D. Conn.—1937), may not be considered authoritative for, after being reversed by the Second Circuit on other grounds in 99 F. (2d) 827 (1938), it was impliedly overruled by that court on the present issue by being ignored in the opinion below.

The Government, in support of its contentions on this point, has discussed at length the basis provisions of the various revenue acts which were enacted in the years 1916 to 1926, inclusive, and also the provisions and regulations of the several Acts which have been in force since the

year 1934. Its position appears to be that the basis provisions of these statutes, none of which is here involved, reveal a general plan to use the value of property at the time of the decedent's death as the basis of the beneficiary; that, as a matter of policy, any departure from such general plan is undesirable; and that under the 1928 and 1932 Acts the departure can be minimized if the phrase "distribution to the taxpayer" is construed to mean distribution to the trustee (*Maguire* brief, pp. 6-8, 15-16).

That position is unsound. As will be shown, the basis provisions of the various revenue statutes enacted prior to 1928 were not interpreted either by the Treasury Department or the courts as prescribing a uniform rule that the basis of all inherited property was the value at the time of the decedent's death. The committees of Congress, in their consideration of the 1928 Revenue Bill, found that the basis requirements of these earlier Acts were indefinite and controversial; and they deliberately changed these provisions by including the third sentence of section 113 (a) (5) which has no counterpart in any of the prior statutes.

The earlier statutes merely provided that the basis of property acquired by bequest, devise or inheritance was its value "at the time of such acquisition." If any general plan was embodied in these terms, the Treasury failed to discover it. Various meanings were accorded to the above-quoted words in Treasury rulings and also in court decisions, depending upon whether the beneficiary's interest was legal, equitable, vested, contingent or otherwise.(5) It was not until after the decision of this Court in *Brewster* v. *Gage*, 280 U. S. 327 (1930), that any certainty as to the meaning of the phrase "at the time of such acquisition" was established. Even now, there is conflict between Circuit

(5) See for example: O. D. 727, 3 Cum. Bull. 53 (1920); G. C. M. 10260, XI-1 C. B. 79, 80 (1932); *Matthiessen* v. *United States*, 65 Ct. Cls. 484, cert. denied 278 U. S. 609 (1928); *McKinney* v. *United States*, 62 Ct. Cls. 180, cert. denied 273 U. S. 716 (1926).

Courts of Appeals as to how that phrase should be construed where the beneficiary's interest in the estate or trust was contingent. See *Reynolds* v. *Commissioner,* 114 F. (2d) 804 (C. C. A. 4th—1940), certiorari granted February 17, 1941; *Van Vranken* v. *Helvering,* 115 F. (2d) 709 (C. C. A. 2d, 1940); *Augustus* v. *Commissioner* (decided Feb. 14, 1941 —C. C. A. 6th) reported in 414 C. C. H. Federal Tax Service, par. 9255.

When the Revenue Bill of 1928 was under consideration by Congress, the Joint Committee on Internal Revenue Taxation recommended that the basis provisions of the earlier Acts, relating to inherited property be changed in order "to make the basis certain and definite." (Report of Joint Committee, Vol. 1, pp. 17, 74, 75). The House Committee on Ways and Means agreed that the term "acquisition" was "indefinite and has given rise to controversy"; and it provided in its Bill that the basis of such property be the value on the date of the decedent's death (H. of R. Report No. 2, 70th Cong., 1st Sess., p. 18). The Senate Finance Committee, however, concluded that the House Bill was "inadequate to take care of a number of situations which frequently arise"; and as examples, it referred to the situation where the property may have been purchased by the executor after the decedent's death and to the situation where the property may have been transferred by the decedent in contemplation of death (Senate Report No. 960, 70th Cong., 1st Sess., p. 26). Thereafter, when the Bill was reconsidered in the conference of both branches of Congress, another provision was added which pertained to revocable trusts (Conference Report No. 1882, 70th Cong., 1st Sess., p. 14). The result was that, when section 113 (a) (5) of the Revenue Act of 1928 was finally enacted, it provided not one basis but three:

1. In the case of personal property acquired by specific bequest, or real estate acquired by will or intestacy, the value "at the time of *the death of the decedent.*"

2. In the case of property acquired by the decedent's estate from the decedent, the value "at the time of *the death of the decedent.*"

3. In *all other cases* where the property was acquired either by will or intestacy, the value "at the time of *the distribution to the taxpayer.*"

In *Brewster* v. *Gage,* 280 U. S. 327 (1930), this Court commented upon this change as follows (p. 337):

> "The deliberate selection of language so differing from that used in the earlier Acts indicates that a change of law was intended. * * * There is no support for the suggestion that subdivision (5) expressed the meaning, or was intended to govern or affect the construction, of the earlier statutes."

The provisions of the third sentence of section 113 (a) (5) evidenced an intention by Congress to depart deliberately from the value-at-death rule, except in the cases specifically mentioned in the first two sentences; and similar provisions are not found in any prior revenue act. The third sentence obviously was intended as a catch-all to provide bases in numerous situations, such as those which the Senate Finance Committee cited as examples. If it is not construed so as to cover such situations, the intention of Congress will in a large measure be defeated.

Many situations would not be covered if the phrase "at the time of the distribution to the taxpayer" were construed, as the Government suggests, to mean the time when the executors deliver the property to the testamentary trustees. For example, there are many cases where the same persons are named both as executors and trustees, the powers of each office are not clearly defined in the will, there is no actual transfer of the property from executors to the trustees, and it is practically impossible to determine when the change of fiduciary capacity takes place. See: *Matter of McDowell,* 178 App. Div. 243 (1917), 164 N. Y. Supp. 1024; *Matter of Robinson,* 155 Misc. 855 (1935),

280 N. Y. Supp. 687; *Matter of Schliemann,* 259 N. Y. 497 (1932). There are cases, like the present one, where the property had not been held by the executors but became part of the trust estate through reinvestment by the trustees. There are other cases where the property did not pass through the hands of executors but was transferred by the decedent to trustees of a revocable trust, a situation which was intended to be covered by the third sentence of section 113 (a) (5) as is shown by the legislative history. Thus the construction for which the Government contends would not provide a basis which is comprehensive and definite, as the committees of Congress intended; it would lead only to uncertainty and confusion.

The Government's suggestion that the departure from the provisions of prior Acts was undesirable and that the unambiguous words of the third sentence of section 113 (a) (5) of the 1928 and 1932 Acts ought to be changed to minimize such departure, should be addressed to the Congress and not to the courts. The basis prescribed by this sentence was established by Congress in the exercise of its own judgment and presumably after consideration of all the supposed advantages and disadvantages suggested to it. It may be that Congress, in drafting the provisions of this sentence concluded that it would be inequitable to tax a beneficiary on increment which had accrued before he obtained any substantial interest in the estate or trust. It may have concluded that there would be less opportunity for tax avoidance if the basis were fixed at the time when the testamentary trust terminated on the death of the life beneficiary, than if it were fixed at such time as the executors elected to turn the property over to the trustees. Also it may have concluded that there were advantages in making the basis provisions definite by having them apply when the property actually came into the hands of the taxpayer.

The effect which the provisions of the third sentence of section 113 (a) (5) would have upon the revenue was not determinable at the time when the 1928 Act was enacted, for the results would depend on future economic conditions

and the facts pertaining to each particular case. In any situation where the property depreciated in value between the date of death and the date of distribution, a larger tax would result from fixing the basis value at "the time of the distribution to the taxpayer" than at the time of the testator's death. Moreover, the various basis provisions of section 113 of the 1928 Act show that Congress did not always elect to tax all increment. For example, under section 113 (a) (4) increment in the hands of a donor is not taxed to the donee; and under section 113 (a) (5) neither the increment in the hands of the testator nor the increment in the hands of the executor is taxed to one who receives a general bequest of personal property.

The weighing of all such considerations and the selection of the particular basis to be used lie within the province of the Congress; and its intentions can best be carried out by giving effect to the literal meaning of the words of the statute. In *United States* v. *Merriam*, 263 U. S. 179 (1923), this Court said (pp. 187-188):

> "But in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used."

To the same effect see *Old Colony Railway Co.* v. *Commissioner*, 284 U. S. 552, 560 (1932).

The words of the third sentence of section 113 (a) (5) are free from ambiguity. The word "property" undoubtedly refers to the particular property sold, for that word is used also in section 111 where the measure of taxable gain is prescribed. The word "taxpayer" is defined in section 701 (a) (13) as "any person subject to a tax imposed by this Act." Accordingly, the plain and rational meaning of the phrase "value of the property at the time of the distribution to the taxpayer" is the value at the time when the property was delivered to the person who sold it and derived the taxable gain. In the instant case, it is the value of the securities at the time when they were delivered to Mr. Gambrill as remainderman on May 5, 1928.

In *Commissioner* v. *Libbey, supra,* the Circuit Court of Appeals for the First Circuit appropriately summarized the situation, as follows (p. 461):

> "The meaning of the third clause of the statute is so plain that it does not call for construction, at least in its application to the facts of this case. 'Distribution to the taxpayer' means what it says—delivery to the taxpayer. It does not mean delivery by the executors to the trustees, where the trustees are not the taxpayer. They are not the taxpayer here."

POINT II

If the basis issue considered under Point I was correctly decided below, the securities which Mr. Gambrill sold within two years from the time he received them as remainderman were not "capital assets."

The question here considered is whether those securities which Mr. Gambrill sold within two years from the time when he obtained them as remainderman of the testamentary trust were "capital assets" within the meaning of the capital gain and loss provisions (section 101) of the Revenue Act of 1928. This statute defines the term "capital assets," so far as is here material, as follows:

> "Sec. 101 (c) (8) 'Capital assets' means property held by the taxpayer for more than two years * * *. For the purposes of this definition—
>
> * * * * * * *
>
> "(B) In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under the provisions of section 113, such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person."

This question is presented only in the event that the basis issue (considered under Point I) was correctly decided below and that the basis of the securities is their value at the time when they were delivered to Mr. Gambrill. There is no dispute that if the basis of the securities to Mr. Gambrill is the same as it would have been to the trustees, subparagraph (B) of section 101 (c) (8) is applicable (petitioner's brief, p. 26) and that the Government cannot establish prejudicial error on this issue (petitioner's brief, p. 22).

The Government's contention is that, even if the securities have a different basis in the hands of Mr. Gambrill than they would have had in the hands of the trustees, they should nevertheless be regarded as capital assets. Its position (brief, p. 21) is that the periods for which Mr. Gambrill held the securities should be computed (1) in the case of those securities which the testatrix had owned in her lifetime, from the time of the testatrix' death in 1897 and (2) in the case of those securities which had been reinvestments of the original trust estate, from the respective dates of their purchase by the trustees.

The Court below rejected that contention with the following statement (R. 34):

> "The Board held that they [the securities] were not [capital assets], and they plainly were not unless the period during which they were held by the trustees can be added to the period between the date of distribution to the taxpayers and the date of sale. There cannot be any such tacking because the property, when held by the respective respondents, did not have 'for the purpose of determining gain or loss from a sale * * *, the same basis * * * in his hands as it would have in the hands' of the trustees."

The respondent submits that the court's holding is correct. The term "capital assets" is a statutory concept and is dependent upon the period for which the taxpayer has

held the property. Since Congress has declared specifically in subparagraph (B) that such period shall include the period for which the property was held "by any other person" only where the taxpayer has the same basis as that other person, there is no warrant for including such prior period in a case, like the present, where the requirement of the statute cannot be met. Subparagraph (B) states expressly that it applies to "property however acquired." The term "taxpayer" is defined by section 701 (a) (13) to mean "any person subject to a tax imposed by this Act"; and in the present case it refers to Mr. Gambrill. The term "person" is defined by section 701 (a) (1) to include "a trust or estate." The plain and rational meaning of subparagraph (B) is, therefore, that if, under the provisions of section 113, the basis of the securities in the hands of Mr. Gambrill is the same as it would have been in the hands of the trustees, tacking of the respective periods of ownership is required; and conversely, if the basis to Mr. Gambrill is not the same, no tacking is permitted.

The Government agrees (brief, p. 26) that if its contentions with respect to the basis issue are sound, subparagraph (B) is called into operation; and it thereby impliedly concedes that the trustees held the securities until the time that the trust was terminated and that Mr. Gambrill held them thereafter until the time of their sale. It cannot argue consistently that, if its contentions with respect to the basis issue are unsound, Mr. Gambrill should be deemed to have held the securities from a time prior to the termination of the trust.

Moreover, the phrase "property held by the taxpayer" is not a term of art either in the law of property or in the law of income taxation; it should receive its ordinary and usual meaning. There is no reason for giving it a strained or unusual construction or for indulging the fiction of "relation" in order to ascertain its meaning.

The ordinary and accepted meaning of the word "held" is "owned" or "had as one's own." When it is said that a

person "held stock" in a corporation, it is commonly understood to mean that he was a stockholder of such corporation. In the specific statutory provision here involved (sec. 101 (c) (8)) the use of the phrases, "(whether or not connected with his trade or business)" and "primarily for sale in the course of his trade or business," to modify "property held by the taxpayer," indicates that Congress employed the word "held" in the sense of "owned."

The Government, in support of its position, relies upon *McFeely* v. *Commissioner*, 296 U. S. 102 (1935), which was distinguished in both of the decisions below. In that case no trust was involved. The taxpayers were respectively residuary legatees, the donee of a widow who had elected to take against her husband's will and one taking under the laws of intestate succession. This Court, in determining the period for which the taxpayers had held the property, stated that "to hold property is to own it"; and it concluded that under the particular facts there present the period of holding began on the date of the decedent's death. The Court apparently regarded the taxpayers as the substantial owners from that date, although they may not have been the title owners. It said (pp. 107-108):

> "Whether under local law title to personal property passes from a decedent to the legatee or next of kin at death subject to a withholding of possession for purposes of administration, or passes to the personal representative for the purposes of administration,—the title of the beneficiary, though derived through the executor relating back to the date of death,—is for present purposes immaterial."

In that case, the possession of the taxpayers was postponed merely for the administration of the estate which was of relatively short duration; and the powers and duties of the executor or administrator were limited. In cases like the present, where a trust is interposed, the period of postponement is ordinarily of longer duration and the

trustees have complete ownership of the property for the purposes of the trust.

Our conclusion that the Court intended in the *McFeely* case to apply the test of substantial ownership in determining the periods for which the taxpayers had held the property appears to find support in *Helvering* v. *San Joaquin Fruit & Investment Co.*, 297 U. S. 496 (1936). The opinions in both cases place emphasis upon the propriety of construing the words of the taxing statute according to their common usage. In the *McFeely* case, the Court said (p. 107):

> "In common understanding, to hold property is to own it. In order to own or hold one must acquire."

In the *San Joaquin* case, the Court said (p. 499):

> "The word 'acquired' is not a term of art in the law of property but one in common use. The plain import of the word is 'obtained as one's own.' Language used in tax statutes should be read in the ordinary and natural sense."

In the present case Mr. Gambrill acquired substantial ownership of the securities under the will at the time of the death of the life beneficiary; and he acquired title to the securities under the will at the time they were distributed to him by the trustees. He was not named in the will and, until after the life beneficiary's death, none of the securities in the trust were earmarked or set aside for him. It is well settled under the laws of New York that neither a life beneficiary nor a remainderman of a trust owns or holds any specific item of property composing the corpus of a trust. *Whiting* v. *Hudson Trust Co.*, 234 N. Y. 394, 407 (1923). Moreover, if additional issue of the life beneficiary had been born, Mr. Gambrill's share in the trust estate would have been reduced. Indeed, until he survived the life beneficiary and her power of appointment terminated upon her death, there was no certainty

that Mr. Gambrill ever would acquire or hold or own any of the property included in the trust estate.

It is unnecessary, as was pointed out by the Board of Tax Appeals in its opinion below (R. 17), to determine whether Mr. Gambrill's holding period began at the date of the life beneficiary's death when he became the substantial owner of the securities, or at the time when the trustees distributed the securities to him and he became the legal owner. None of the securities here involved was sold more than two years after either of these dates.

LAST POINT.

The decision of the Circuit Court of Appeals for the Second Circuit should be affirmed.

Respectfully submitted,

Sidney W. Davidson
Allin H. Pierce
Counsel for the Respondent.

Dated, New York, N. Y.,
February 25, 1941.

BLANK PAGE

APPENDIX.

Revenue Act of 1928, c. 852, 45 Stat. 791:

Sec. 22 (b). *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * *

(3) *Gifts, Bequests, and Devises.*—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income); * * *.

Sec. 101. *Capital Net Gains and Losses.*

* * * *

(c) *Definitions.*—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

* * * * * * *

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. For the purposes of this definition—

(A) In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged, if under the provisions of section 113, the property received has, for the pur-

pose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged.

(B) In determining the period for which the taxpayer has held property however acquired there shall be included the period for which such property was held by any other person, if under the provisions of section 113, such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as it would have in the hands of such other person.

(C) In determining the period for which the taxpayer has held stock or securities received upon a distribution where no gain is recognized to the distributee under the provisions of section 112 (g) of this title or under the provisions of section 203 (c) of the Revenue Act of 1924 or 1926, there shall be included the period for which he held the stock or securities in the distributing corporation prior to the receipt of the stock or securities upon such distribution.

Sec. 111. *Determination of Amount of Gain or Loss.*

(a) *Computation of gain or loss.*—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in section 113, and the loss shall be the excess of such basis over the amount realized.

Sec. 113. *Basis for Determining Gain or Loss.*

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

(5) *Property Transmitted at Death.*—If personal property was acquired by specific bequest, or if real property was acquired by general or specific devise or by intestacy, the basis shall be the fair market value of the property at the time of the death of the decedent. If the property was acquired by the decedent's estate from the decedent, the basis in the hands of the estate shall be the fair market value of the property at the time of the death of the decedent. In all other cases if the property was acquired either by will or by intestacy, the basis shall be the fair market value of the property at the time of the distribution to the taxpayer. In the case of property transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death;

* * * * *

(b) *Property acquired before March 1, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be:

(1) the cost of such property (or, in the case of such property as is described in subsection (a) (1), (4), (5), or (12) of this section, the basis as therein provided), or

(2) the fair market value of such property as of March 1, 1913,

whichever is greater. In determining the fair market value of stock in a corporation as of March 1, 1913, due regard shall be given to the fair market value of the assets of the corporation as of that date.

Sec. 701. *Definitions.*

(a) When used in this Act—

(1) The term "person" means an individual, a trust or estate, a partnership, or a corporation.

* * *

(13) The term "taxpayer" means any person subject to a tax imposed by this Act.

BLANK PAGE